

ST 01-2

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**DEPARTMENT OF REVENUE
STATE OF ILLINOIS
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE, as
Responsible Officer of ABC, Inc.,
TAXPAYER**

**No. 00-ST-0000
IBT No. 0000-0000
NPL No. 0000
NOD No. 0000**

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Thomas G. Berg, appearing on behalf of John Doe; Mr. Marc L. Muchin appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to John Doe's (hereinafter "Doe" or "taxpayer") protest of Notice of Penalty Liability No. 7102 (hereinafter the "NPL") and Notice of Deficiency No. 3468 (hereinafter the "NOD"), as responsible officer of ABC, Inc. (hereinafter "ABC"), a/k/a The Alphabet Company. The NPL represents a penalty liability for Retailers' Occupation Tax of ABC due to the Department for October, 1997, through April, 1998. The NOD represents a penalty liability for withholding taxes for the first and second quarters of 1998. A hearing was held on this matter on October 31, 2000, with Doe providing oral testimony. Following submission of all

evidence and a review of the record, it is recommended that the NPL and the NOD be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. 0000, dated June 10, 1999, which shows a penalty for sales tax liability of ABC, Inc. of \$36,357.52 for October, 1997, through April, 1998, and NOD No. 0000, dated June 11, 1999, which shows a total liability due and owing for unpaid withholding tax of \$1,349.08 for the first and second quarters of 1998. Dept. Ex. Nos. 1, 2.
2. ABC, Inc., known as The Alphabet Company, was located on Anywhere Road in Anywhere. The restaurant served food and alcoholic beverages. Tr. pp. 10-11.
3. ABC, Inc. was formed in December of 1996 and the Alphabet was purchased and opened in January of 1997. Tr. pp. 10-11.
4. Doe signed the “NUC-1, Illinois Business Registration” form as “president” of ABC, Inc. On question 14 of the form, signed January 9, 1997, Doe accepted “personal responsibility for the filing of returns and the payment of taxes due.” Tr. pp. 18-19; Dept. Ex. No. 3.
5. Doe owned 50% of the stock in ABC and invested \$55,000 to \$60,000 in the business. Tr. pp. 20, 24.

Conclusions of Law:

There are two types of taxes at issue here. The Department seeks to impose personal liability on Doe pursuant to Section 1002(d) of the Illinois Income Tax Act for the failure to pay withholding taxes. 35 ILCS 5/1002(d). In addition, the Department seeks to impose personal liability on Doe for failure to remit Retailers’ Occupation Tax (“ROT”).

The personal liability penalty for both taxes is imposed by Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section.
35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NPL establishes the Department’s *prima facie* case with regard to both the fact that Doe was a “responsible” officer and the fact that he “willfully” failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill.App.3d 11 (1st Dist. 1978).

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S.

821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that Doe was a responsible person under the statute. Doe testified that he was president of ABC and a 50% shareholder. Tr. pp. 18, 20. Doe admitted signing the “NUC-1, Illinois Business Registration” as “president” and in question 14 of the form, he accepted “personal responsibility for the filing of returns and the payment of taxes.” Dept. Ex. No. 3. ABC’s bylaws are not in evidence, and the record does not show what duties and responsibilities were vested in the office of president. However, the president of a corporation is usually charged with overall responsibility for the management of the corporation, and without any evidence to the contrary, there is no reason to assume that this was not the case with ABC.

Doe testified that he “walked out” of the business in February, 1998, which is included in the period covered by both the NPL and the NOD. Tr. p. 17. After February, 1998, Doe “didn’t have anything to do with [the business].” Tr. p. 17. Doe’ counsel stated in opening arguments that “Doe had, in fact, employed an attorney to represent him in a buy-out which was never exercised and the sale was never consummated. He just simply walked away from the business.” Tr. p. 6. No documentation was admitted showing evidence of the buy-out. The attorney employed by Doe did not testify. No corporate documents or annual reports were admitted as evidence to show resignations, officers, changes in officers, or minutes of corporate meetings. Without any documentary evidence to the contrary, I must conclude that Doe held the position of president over the entire time period covered by the NPL and NOD.

Doe testified that he was “probably” a signatory on corporate checking accounts, but he did not remember signing any checks. Tr. p. 28. No checks, bank signatory cards or check approval

authorizations were admitted as evidence at the hearing. The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473, (E.D.N.Y 1981), aff'd, 671 F.2d 492 (2d Cir. 1982).

Doe offered conflicting testimony as to who determined which creditors of the restaurant were paid. He testified on direct examination that his partner “was taking care of the bills, then he was taking care of all of the other necessary papers to submit to the State or anything else.” Tr. p.

23. The following exchange occurred on cross-examination:

Q: If there were some bills, [say] the food and the liquor and the supplies – you know, that your partner – that came into the restaurant or the rent or the electricity or the insurance, how was it determined what order those bills were going to be paid?

A: What was necessary was the rent, the electricity, gas.

Q: Did you decide that or with your partner together?

A: Not really, but it was mutual.

Tr. p. 28.

It is unclear from this testimony whether Doe and/or his partner determined the order of debt payment. If Doe allowed his partner to make decisions as to what creditors were to be paid, and chose not to be involved in the day-to-day operations of ABC, this does not make him less of a “responsible” officer. Doe testified that he was “probably” a signatory on corporate checking accounts, and accordingly, he could have written a check for taxes. Although Doe may have shared the responsibility for check signing with his partner, this does not mean that Doe was not responsible. The statute does not confine liability to only one person or to the person most responsible. Responsibility is a matter of status, duty and authority, not necessarily knowledge. Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979). With the status of a 50% shareholder and president of ABC, and the authority to write checks, Doe was a responsible officer.

Doe testified that he worked at the restaurant as a host on the night shift, and helped out at the bar. Tr. pp. 12, 21. According to Doe, he did not keep the books for the restaurant, purchase supplies, hire or fire employees, or prepare sales and withholding tax returns. Tr. p. 12. According to Doe, his partner and an accountant hired by his partner prepared the tax returns and kept the books and records. His partner hired and fired employees, and had “total and complete control over who was working in the restaurant.” Tr. pp. 14, 29. Although Doe saw the checks that were issued to employees, he never signed them. Tr. p. 15. Doe testified that he had no personal knowledge that debts were due and owing or that the restaurant was delinquent at any time. Tr. p. 16. According to Doe, he first knew that sales and withholding taxes were not paid when he received the NPL and NOD in June of 1999. Tr. p. 16.

Doe’ testimony as to his total lack of involvement in the restaurant is not credible. Doe invested \$50,000 to \$60,000 in the restaurant and it is inconceivable that he would completely turn over the operation of the restaurant to his partner. Doe’ testimony that he was unaware that the restaurant’s debts were not being paid is also not credible:

- Q: What about your \$50,000 or \$60,000 interest; did you just see that go?
A: I would never get any money out of the place, I was losing it. So I figured out that it was a lost case for me.
Q: In other words, the business was going downhill?
A: Yes. Plus I never got paid when I was working in the place.
Q: In all during 1997, you never took a salary?
A: No.
Tr. p. 26.

Doe also testified that he did not believe that his partner ever got paid. Tr. p. 31. The fact that the business was “going downhill” and that Doe and his partner were not being paid would surely have been an indication that debts were not being paid. Doe also testified that he and his partner talked “almost every day” and discussed finances: “[w]e [could] see that the place wasn’t doing great.” Tr.

p. 31. In light of this testimony, it is inconceivable that Doe never once questioned whether sales and withholding taxes were being paid, never once checked ABC's bank statements to see if taxes had been paid, and never once asked the accountant if he knew whether tax returns were being filed during the periods covered by the NPL and NOD.

The evidence shows then that Doe was in a responsible position with ABC in which he knew or should have known whether returns were filed and taxes paid. In order to overcome the Department's *prima facie* case, evidence must be presented which is consistent, probable and identified with the corporation's books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). When the Department established its *prima facie* case, the burden shifted to Doe to overcome the presumption of responsibility through sufficient evidence. Branson, *supra*. Not one document was admitted by Doe in support of his position. Without any documentary evidence to support his case, and because the testimony with regard to his total non-involvement in the restaurant is contradictory and not credible, Doe has failed to rebut the Department's presumption that he was a responsible party under the statute.

Doe attempted to rebut the presumption of willfulness by testifying that he was not involved in the day to day operations of the restaurant. According to Doe, his partner and an accountant prepared the tax returns and kept the books and records for the corporation. Tr. p. 14. Doe was asked the following question on cross-examination: "Was [your partner] under your supervision when you were president of the corporation?" He responded "yes". Doe was then asked "did he report to you." He responded "no." Tr. p. 30.

This testimony is inconsistent and not credible. If Doe's partner was under his "supervision," then the partner's failure to pay the taxes is directly attributable to Doe. Assuming *arguendo* that Doe delegated responsibilities to his partner and the partner did not "report" to him,

Doe' conduct was still willful. Responsible officers are liable if they delegate bookkeeping duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the retailers' occupation tax returns and payments. Branson *supra* at 267. A responsible person cannot escape his obligation to ensure that taxes are paid simply by delegating the responsibility to others. Wright v. United States, 809 F.2d 425 (7th Cir. 1987).

Doe also attempted to rebut the presumption of willfulness by repeatedly testifying that he "walked away" from the business in February of 1998. Tr. p. 17. After February, 1998, Doe "didn't have anything to do with [the business]." Tr. p. 17. Counsel for Doe stated in closing arguments that "it is only when [Doe] is leaving that the liabilities begin to incur, and only after he left do they, in fact, some of the returns that were due, for example, the sales tax and the 941 taxes. He was already gone."

There are several problems with this argument. First, it is not believable that Doe just "walked away" from a \$60,000 investment. Second, the NPL covers the period October, 1997, through April, 1998, and the NOD covers the first two quarters of 1998. If Doe "walked away" in February of 1998, he was not leaving when the liabilities "begin to occur," as counsel suggested. Approximately 75% of the sales tax liability detailed on the NPL was incurred through February, 1998. Third, as discussed previously, no documentary evidence was admitted to show that Doe ever resigned from the corporation or "walked away" and his testimony alone is not sufficient for me to conclude that he did, in fact, resign.

The facts are that on the "NUC-1," Doe, as president, accepted responsibility for the filing of returns and the payment of taxes. He had the authority to write checks and could have written a check for taxes. If Doe' partner was under his "supervision," I must conclude that when the taxes were not paid, they were not paid with Doe' approval and this satisfies the willful requirement of

the statute. If Doe truly delegated to his partner, this does not relieve him of his responsibility for the taxes. Doe has not rebutted the Department's *prima facie* case that he willfully failed to pay the sales and withholding taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000 and Notice of Deficiency No. 0000 issued against John Doe be finalized as issued.

ENTER:

Kenneth J. Galvin
Administrative Law Judge

January 10, 2001